IT 07-0001-PLR 03/23/2007 APPORTIONMENT – SALES FACTOR

Private Letter Ruling: Gain on sale of unitary subsidiary is business income, but receipts are excluded from the sales factor numerator and denominator under 86 Ill. Adm. Code Section 100.3380(c)(2).

March 23, 2007

Dear:

This is in response to your dated September 7, 2006, in which you request a Private Letter Ruling. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 86 Ill. Adm. Code Section 1200.110 appears to be contained in your request, except for the Power of Attorney form, and it was submitted following our supplemental telephone conversation. The Private Letter Ruling will bind the Department only with respect to COMPANY1, Inc. for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY1, Inc. nor a related taxpayer is currently under audit nor involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

General Information

1. This Private Letter Ruling ("PLR") is not requested for hypothetical or alternative proposed transactions, but rather to determine the income tax consequences of actual transactions engaged in by COMPANY1, Inc., as described below.

2. COMPANY1, Inc. is not currently engaged in litigation with the Department with regard to this or any other tax matter.

3. The Department has not previously ruled regarding this matter for COMPANY1, Inc. Neither COMPANY1, Inc. nor COMPANY2 LLP has submitted the same or similar issue to the Department on behalf of COMPANY1, Inc.

4. We are aware of no authority contrary to the authorities referred to and cited below.

Statement of Facts

COMPANY1, Inc. is a privately held company. Since its incorporation, COMPANY1, Inc. has maintained its commercial domicile in the State of Illinois and has been a corporation taxed under Subchapter C of the Internal Revenue Code. For over 25 years, COMPANY1, Inc., as the common parent, has annually filed a Federal consolidated income tax return with its numerous wholly-owned corporate subsidiaries and with CORPORATION1, a corporation in which COMPANY1, Inc., throughout the period, owned less than 100% of the stock but in which COMPANY1, Inc. maintained over 80% voting control. Similarly, for over 25 years, COMPANY1, Inc., COMPANY1, Inc.'s wholly-owned subsidiaries, and CORPORATION1 have comprised a unitary business group filing annual unitary Illinois corporate income tax returns. In that period of time, COMPANY1, Inc., COMPANY1, Inc.'s wholly-owned subsidiaries, and CORPORATION1 have derived income from operations in a number of states and filed corporate income tax returns in a number of states.

For over 25 years, CORPORATION1 was COMPANY1, Inc.'s largest business unit. For several business-related reasons, including a desire to better diversify COMPANY1, Inc.'s business holdings and to focus on expanding its other existing businesses and potential new businesses, on March 15, 2005, COMPANY1, Inc.'s shareholders approved the merger of CORPORATION1 into a transitory merger subsidiary wholly-owned by CORPORATION2. The merger, a tax-free reorganization under Section 368(a)(1)(A) of the Internal Revenue Code, was effectuated on August 17, 2005. In the merger, for each share of CORPORATION1 that it owned, COMPANY1, Inc. received one share of CORPORATION2, a publicly traded corporation. Immediately after the merger, COMPANY1, Inc. owned CORPORATION2 shares comprising approximately 20% of CORPORATION2's total stock ownership. Since August 17, 2005, COMPANY1, Inc. does not maintain voting control of CORPORATION2, and though one COMPANY1, Inc. employee sits on CORPORATION2's nine-member board of directors, COMPANY1, Inc. has not participated in the management of CORPORATION2. Also, since August 17, 2005, CORPORATION2 is not a member of COMPANY1, Inc.'s Federal consolidated return group or its Illinois unitary business group.

To fulfill the diversification and other strategic business initiatives referred to above, it was at the time of the merger, and remains, COMPANY1, Inc.'s desire and intent to sell a substantial number of the CORPORATION2 shares which it received in the merger. These sales have and will produce significant capital gains to COMPANY1, Inc. Complex Federal securities laws restrict the number of CORPORATION2 shares that COMPANY1, Inc. can sell at one time. Since August 17, 2005, COMPANY1, Inc. has engaged in one derivative transaction with respect to CORPORATION2 shares (which will close in a few months), and has made one actual sale of CORPORATION2 shares. Each transaction involved an amount of shares very close to the then applicable sales volume limitation under Rule 144. With respect to the remaining CORPORATION2 shares, COMPANY1, Inc. intends to substantially reduce its exposure to the risk inherent in a large single holding, via strategic sales, until such time as the holding has been substantially reduced. COMPANY1, Inc. is not in the business of selling the stock of companies.

Since August 17, 2005, COMPANY1, Inc. has continued to carry on its other business units as going concerns.

With the exception of a limited number of shares owned directly by COMPANY1, Inc., COMPANY1, Inc.'s stock ownership in CORPORATION2 is held by two STATE single member limited liability companies, each of which is wholly-owned by COMPANY1, Inc. and is treated as a disregarded entity for Federal income tax purposes.

Pertinent Law and Regulations

Section 201 of the Illinois Income Tax Act states in pertinent part that "[a}tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 on the privilege of earning or receiving income in or as a resident of this State."

Section 1501(a)(20) of the Illinois Income Tax Act provides that the term "resident" includes individuals, estates and trusts.

Section 1501(a)(14) states that a "nonresident means a person who is not a resident."

Section 1501(a)(18) defines the term "person" to include corporations.

IITA Section 1501(a)(18) states that a "taxpayer" "means any person subject to the tax imposed by this Act."

Section 1501(a)(1) of the Illinois Income Tax Act sets forth the statutory definition of the term "business income." This Section provides:

The term "business income" means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of the deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

Section 1501(a)(13) provides "[t]he term 'nonbusiness income' means all income other than business income or compensation."

IITA Section 303 sets forth the manner in which the nonbusiness income of any person other than a resident is allocated. Section 303(b)(3) states that "Capital gains and losses from sales or exchanges of intangible personal property are allocable to this State if the taxpayer had its commercial domicile in this State at the time of such sale or exchange."

IITA Section 304 sets forth the manner in which the business income of a corporation is apportioned between Illinois and one or more other states. IITA Section 304(h) states that for tax years ending on or after December 31, 2000 the business income of a corporation is apportioned by the sales factor. Section 304(a)(3) states in relevant part that the "sales factor" is "a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year."

IITA Section 304(a)(3)(C) provides the statutory rules for apportioning income from sales other than sales of tangible personal property and certain intangibles apportioned pursuant to Section 304(a)(3)(B-1). Section 304(a)(3)(C) states that such sales "are in this State if: (i) the income-producing activity is performed in this State; or (ii) the income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State based on performance costs."

IITA Section 304(f) states that "if the allocation and apportionment provisions of subsections (a) through (e) an of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable: . . . (4) the employment of any other method to effectuate an equitable allocation and apportionment of the person's business income."

Section 100.3380 of the IDOR rules (86 Ill. Adm. Code 100.3380) was adopted pursuant to the Director's authority under IITA Section 304(f). Section 100.3380(c) sets forth a number of special rules for the determining the sales factor. Section 100.3380(c)(2) provides that "where gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded."

Requested Rulings

1. COMPANY1, Inc. may elect to treat the gains from the sale of its CORPORATION2 stock as "business income" pursuant to the election afforded by IITA Section 1501(a)(1).

2. The gross receipts received by COMPANY1, Inc. from the sale of CORPORATION2 stock must be excluded from the numerator and the denominator of the sales factor pursuant to Section 100.3380(c) of the IDOR rules.

Analysis

COMPANY1, Inc. earns income in the State of Illinois and is a taxpayer subject to the Illinois Income Tax Act.[1] As a corporation, COMPANY1, Inc. is a non-resident of Illinois for Illinois income tax purposes.[2] As a non-resident, COMPANY1, Inc. is required to determine the amount of business income apportionable to Illinois by comparing sales in Illinois to sales everywhere.[3] The taxable year(s) in which COMPANY1, Inc. recognizes gains on the sale of CORPORATION2 stock began after January 1, 2003. Therefore, COMPANY1, Inc. may elect to treat all income other than compensation as business income.[4] Section 100.3380(c) of the rules of the Illinois Department of Revenue requires that COMPANY1, Inc. exclude the sale of its stock interest in CORPORATION2 from the numerator and denominator of the sales factor as "an incidental or occasional sale of assets used in the regular course of the person's trade or business . . . ."[5] In IT 01-0043 GIL, the Illinois Department of Revenue's Legal Division opined that the gain from a deemed sale of assets under IRC 338(h)(10) may be excluded from the sales factor pursuant to Section 100.3380(c) in an appropriate case.[6] The current facts mandate exclusion of the gain from the Illinois sales factor.

Request for a Conference

We respectfully request a personal conference to discuss these matters orally, if the Department believes such may be helpful or if the Department of Revenue may otherwise intend to render a ruling contrary to our client's position.

If you have any questions or would like to discuss this matter further, please contact me at your convenience at (312) 602-9004.

<u>Ruling of the Department</u>

1. *COMPANY1, Inc. may elect to treat the gains from the sale of its CORPORATION2 stock as "business income" pursuant to the election afforded by IITA Section 1501(a)(1).*

   Agreed. The sales of the CORPORATION2 stock occurred on or after 8/17/05, which is well after the 1/1/03 effective date of IITA 1501(a)(1).

2. *The gross receipts received by COMPANY1, Inc. from the sale of CORPORATION2 stock must be excluded from the numerator and the denominator of the sales factor pursuant to Section 100.3380(c) of the IDOR rules.*

   Agreed. Based upon your representations that the merger of CORPORATION1 into the CORPORATION2 subsidiary is a unique event, and that the resultant stock transactions are not part of COMPANY1, Inc.'s usual and ordinary course of business, the gain from these incidental transactions falls under the rule of IITA Regulation Section 100.3380(c)(2). Resultantly, such gain may be excluded from both the numerator and denominator of COMPANY1, Inc.'s sales factor when apportioning its income.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax

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[1] IITA 201 (35 ILCS 5/201)
[2] IITA 1501(a)(14) (35 ILCS 5/1501)
[3] IITA 304 (35 ILCS 5/304)
[4] IITA 1501(a)(1) (35 ILCS 5/1501)
[5] 86 Ill. Adm. Code 100.3380

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[6] This ruling was issued in the form of a general information letter. Although general information are not binding on the Illinois Department of Revenue pursuant to 2 Ill. Adm. Code 1200.120(c), general information letters are instructive as they contain general discussions of tax principles or applications. In the absence of regulations or binding legal precedent, they can provide the best evidence of the IDOR's position various matters.